



SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1945.

No. 819.

CANADIAN RIVER GAS COMPANY,
 Petitioner,
against

JOSEPH T. HIGGINS, formerly United States Collector
 of Internal Revenue for the Third District of
 New York,

Respondent.

*ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES
 CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.*

**PETITION FOR REHEARING OF PETITION FOR
 WRIT OF CERTIORARI.**

*To The Honorable The Chief Justice of The United States
 and The Associate Justices of The Supreme Court of
 The United States:*

Comes now the petitioner in the above-entitled cause
 and presents this its petition for a rehearing of its petition
 for certiorari, and in support thereof respectfully shows:

I.

Rehearing should be granted because the decision of
 the Court below, which was the basis for the petition for
 certiorari, is in clear conflict with the decision of this Court
 in *Burton-Sutton Oil Company, Incorporated, Petitioner,*
v. Commissioner of Internal Revenue, October Term, 1945,

No. 361, decided April 22, 1946, since the denial of the petition for certiorari.

II.

What is presented in this case is the federal income tax status of advance royalties paid by lessees of oil or gas leases. In its suit in the District Court, from which appeal was taken to the Circuit Court of Appeals, the taxpayer maintained that advance royalties becoming applicable to aliquot portions of current production are deductible by the operating lessee from current receipts. The petitioner also contended in the alternative that if the proper amounts of such advance royalties are not to be treated as payments against current production, and hence deductible by it, the lessee is entitled to percentage depletion in respect of the production thus treated as part of its gross income from the property. The decision below was adverse to petitioner on both points. The respondent and the petitioner were in agreement on the facts in this case.

In making its principal argument, petitioner relied upon decisions of this Court that advance royalties such as are here involved are not payments for an interest in the oil or gas property but are payments for the right to remove oil or gas. These decisions were rendered in cases relating to the taxes of lessors, not of lessees, and clearly held that such payments are not to be treated by the lessors as payments received for an interest in the property but instead as payments in advance for oil or gas to be removed.

Burnet v. Harmel, 287 U. S. 103;

Herring v. Commissioner, 293 U. S. 322;

Kirby Petroleum Company v. Commissioner,
66 S. Ct. 409 (January 28, 1946);

Helvering v. Twin Bell Syndicate, 293 U. S. 312;

Douglas v. Commissioner, 322 U. S. 275.

The Circuit Court of Appeals rejected this argument as follows:

"The fallacy of that argument lies in the assumption that since the advance royalties are taxed to the lessor as ordinary income because they are part of the consideration passing to the lessor for granting to the lessee the right to obtain a series of transfers of the oil as produced, *Burnet v. Harmel, supra*, the grant in the hands of the lessee is not to be treated as a capital asset nor the advance royalties paid for it as a capital investment. * * *

"What the lessor gets *for* the lease and how that should be taxed does not control decision as to the character of what the lessee gets *under* the lease. Just as advance royalties may be consideration for a lease and also ordinary income to the lessor, *Burnet v. Harmel, supra*, they may be capital investments by a lessee when paid for capital assets. * * * So it does not follow, as the plaintiff argues, that because the advance royalties are taxable as ordinary income to the lessors the lessee did not make a capital investment when it paid them in consideration for the leases." (R. 98-99)

Petitioner maintained that the decision of the Court below was inconsistent with the decisions of this Court above referred to. However, that decision was in harmony with decisions of two other Circuit Courts of Appeal, and petitioner was then unable to cite a decision of this Court which dealt with the question in the case of a lessee.

The decision in the *Burton-Sutton Oil Company* case is a decision as to the status of royalty payments made by an operating lessee and squarely supports the argument of the petitioner.

In the *Burton-Sutton Oil Company* case the Court dealt with the right of an operating company to deduct from its

gross receipts an amount substantially equivalent to 50% of the net proceeds of oil produced and sold from property which the operating company was required to pay under a contract to the Gulf Refining Company. The Court said:

“A decision on the category of expenditures to which these 50% disbursements belong affects both the operators who make them and the owners, lessors, vendors, grantors, however they may be classed, who receive them. If they are capital investments to one, they are capital sales to the other. If they are rents or royalties paid out to one, they are rents or royalties received by the other.”

The Court thus holds that such a payment cannot be a capital investment to the operating company where it is ordinary income and not a capital sale to the recipient. The position taken by this Court was the position taken by Judge Learned Hand in his dissent below, where he said:

“The plaintiff merely asks that the lease shall be construed in the same way when the lessee is taxed. It says that if a ‘bonus’ is ‘advance royalties’ and a payment for units to be later withdrawn, which remained the lessor’s while they are *in situ*, it must be ‘advance royalties’ when the opposite party, the lessee, is taxed: that the rights cannot vary as one looks through different ends of the same document.” (R. 100)

The only difference in the facts involved in the *Burton-Sutton Oil Company* case and the facts involved in this case is that the royalties paid by the lessee in the *Burton-Sutton Oil Company* case were current royalties, whereas in the case below the royalties involved were advance royalties paid at the time of the execution of the lease, but there is no distinction in tax status between advance royalties and current royalties.

As stated in the *Burton-Sutton* decision,

“It is not material whether the payment to the assignor is in oil or in cash which is the proceeds of the oil, *Helvering v. Twin Bell Syndicate*, 293 U. S. 312, 321, nor that some of the payments were in the form of a bonus for the contract. *Burnet v. Harmel*, 287 U. S. 103, 111; *Murphy Oil Co. v. Burnet*, 287 U. S. 299, 302.”

In *Anderson v. Helvering*, 310 U. S. 404, 409, this Court said:

“The holder of a royalty interest—that is, a right to receive a specified percentage of all oil and gas produced during the term of the lease—is deemed to have ‘an economic interest’ in the oil in place which is depleted by severance. * * * Cash bonus payments, when included in a royalty lease, are regarded as advance royalties, and are given the same tax consequences.”

In the same case the Court said (p. 407):

“It is settled that the same basic issue determines both to whom income derived from the production of oil and gas is taxable and to whom a deduction for depletion is allowable. The issue is, who has a capital investment in the oil and gas in place and what is the extent of his interest.”

In *Douglas v. Commissioner*, 322 U. S. 275, 280, the Court said:

“Royalty or bonus payments in advance of actual extraction of minerals are, like sales after severance or royalty payments on actual production, gross income and not a recovery of capital.”

It is therefore apparent that the decision below is wholly in conflict not only with the principle of the earlier deci-

sions of this Court in the lessor cases, relied upon by petitioner in its petition for certiorari, but also with the decision of this Court in the lessee case handed down after the petition was denied.

On this ground certiorari should be granted.

Certiorari should also be granted on petitioner's alternative point as the two questions are interdependent and have been inconsistently decided below as shown in the petition for certiorari.

Wherefore, petitioner respectfully petitions for a rehearing of the petition for a writ of certiorari and respectfully prays that a writ of certiorari issue under the seal of this Court to review the decision of the Circuit Court of Appeals for the Second Circuit in the above case.

Respectfully submitted,

ARTHUR A. BALLANTINE,
GEORGE E. CLEARY,
Counsel for Canadian River Gas
Company, Petitioner.

Certificate of Counsel.

We, ARTHUR A. BALLANTINE and GEORGE E. CLEARY, counsel for the above-named petitioner, do hereby certify that the foregoing petition for a rehearing of this cause is presented in good faith and not for delay.

ARTHUR A. BALLANTINE,
GEORGE E. CLEARY,
Counsel for Petitioner.

